pension reform

a report by the
national council of welfare

may 1984

Canada

P E N S I O N   R E F O R M

A Report by the
National Council of Welfare

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FOREWORD

Pension reform is a complicated subject, even for the specialist. Canada's retirement income system is comprised of three major levels and, within each level, several elements - a foundation of federal and provincial income security programs; a second tier of public pension plans (the Canada Pension Plan and Quebec Pension Plan); and a third layer of private pension plans of varying design , Registered Retirement Savings Plans, and special tax provisions that encourage saving for retirement and lower taxes for the elderly. Most people have only a vague idea of how this complex system operates, let alone understand what is wrong with it and what can be done to set it right. Yet the outcome of the pension reform process will touch every Canadian who pays taxes, contributes to pension or savings plans, and reaches the age of retirement.

The National Council of Welfare has prepared a series of studies on the aged and the retirement income system. The reports are intended to provide the basic facts which the ordinary Canadian needs to understand and participate in the pension debate.

Financing the Canada Pension Plan explains how the Canada Pension Plan is financed and the use of surplus funds to provide loans to the provinces. It examines future demands on the CPP and proposes a move to pay-go funding and a gradual increase in contribution rates. Sixty-Five and Older looks at the past and future growth of Canada's aged population and charts trends in poverty and income statistics; the report also discusses shelter costs, subsidies and services, and the impact of income security programs on the aged.

The report that follows, Pension Reform, reviews the three major routes to pension reform; discusses the package of pension proposals contained in the February 1984 federal Budget; and offers the National Council of Welfare's recommendations for long-term reform of the retirement income system. A companion report, Better Pensions for Homemakers, criticizes and offers an alternative to the proposal for a homemaker pension from the Canada and Quebec Pension Plans. A Pension Primer is a layman's guide to Canada's retirement income system. It explains how that complex system operates and reveals its strengths and weaknesses.

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THE NEED FOR REFORM

Our retirement income system is supposed to perform two essential tasks. The first is to guarantee all elderly Canadians a basic acceptable income. The second is to replace enough income that pensioners do not suffer a drop in their standard of living when they retire.

There is abundant evidence that Canada's retirement income system meets neither its anti-poverty nor income-replacement objectives. Three companion studies in the National Council of Welfare's series on pension reform, Sixty-Five and Older, A Pension Primer, and Financing the Canada Pension Plan, analyze at length the economic position of the elderly and the strengths and shortcomings of the pension system. What follows is a synopsis of the key findings of those reports.

The Anti-Poverty Objective

The federal **Old Age Security** (OAS) and **Guaranteed Income Supplement** (GIS) programs address the anti-poverty objective of the retirement income system. All Canadians 65 and older receive OAS benefits, and half of the aged have incomes so low that they qualify for the GIS. Together the OAS and GIS provide a maximum monthly income of $534 for a single person and $945 for an aged couple.[1]

A third federal income security program, the **Spouse's Allowance,** is available to persons aged 60 to 64 whose spouse receives the Guaranteed Income Supplement. The income-tested Spouse's Allowance is equal to the OAS plus GIS at the married rate, and is continued to widowed spouses until they turn 65 and get OAS/GIS.

There is much to be said in favor of Ottawa's income security net for the elderly. The OAS and GIS are among the best known and most popular government programs in Canada. They are inexpensive to administer and involve little red tape.[2] They are essential to the economic security of elderly Canadians, contributing one-third of the income of aged couples and 40 percent of the income of single elderly persons. They furnish almost all the income of women and men who are over 65 and under the poverty line.[3]

Improvements to federal income security programs for the aged over the years - lowering the age of eligibility for Old Age Security from 70 to 65, adding the Guaranteed Income Supplement in 1967 and the Spouse's Allowance in 1975, raising OAS and GIS benefit levels - have helped increase the income of the elderly and reduce the extent of poverty among them. Between 1967 and 1983, combined benefits from the OAS and GIS increased in real value by 52 percent for the single elderly and 34 percent for pensioner couples. In 1973, payments were fully indexed to the cost of living on a quarterly basis, a feature that has proved enormously important in protecting elderly Canadians' limited income from the ravages of high inflation in recent years.

The provincial governments also have played a significant role in bettering the economic situation of their elderly residents. All provinces now offer some type of tax relief for the aged, and six provinces and the two territories provide income supplements for the aged poor.[4]

Despite these virtues, government income security programs still do not provide an adequate income floor for all elderly Canadians, notably the large and growing group of the single aged (most of them women). A single pensioner is assured an income of $6,634 from the OAS and GIS this year - $3,266 below the estimated poverty line of $9,900 for a city of 500,000 or more. An elderly couple's guaranteed income of $11,435 is $1,628 less than the estimated poverty line of $13,063 for a metropolitan center. Even in provinces which supplement the federal programs, the combination of federal and provincial benefits leaves almost all single aged men and women and many couples under the low-income line.

The poverty statistics tell the tale. On the positive side, the risk of poverty has declined significantly for families with elderly heads. In 1969, 41.4 percent of families led by persons 65 and older were poor, but by 1982 the rate had fallen to 11.7 percent, thanks in large part to improvements in public programs for the aged. However there has been less progress in reducing the risk of poverty for unattached elderly Canadians, 69 percent of whom were low-income in 1969 and 58 percent - well over half - in 1982.[5]

Women have fared badly. The poverty rate for families led by aged women has actually increased in recent years and at last count stood at 25 percent, as opposed to just 10 percent for families with elderly male heads. Six in ten unattached elderly women live on low incomes, compared to just under half of unattached men 65 and older. There are almost four times as many poor unattached elderly women as men.

The Income-Replacement Objective

The Canada and Quebec Pension Plans make up the second level of the retirement income system, and private pension and retirement savings plans encouraged by tax deductions form the third tier. Together the C/QPP and private pension and savings plans are intended to ensure an adequate amount of replacement income for retired Canadians.

The **Canada/Quebec Pension Plan** offers a number of attractive features. (Since the CPP and QPP are essentially the same in design, we will refer to them as one plan). It covers the entire labor force throughout the country - employees and the self-employed, part-time and seasonal workers as well as those employed full-time, men and women, and workers of all ages. It is a fully portable pension plan that covers the working person for all his or her career, no matter how many jobs or employers he or she has. Benefits are fully vested, which means that the C/QPP contributor is guaranteed all employer contributions on his or her behalf. Both pension credits and benefits are fully protected against inflation. In addition to a retirement pension, the C/QPP provides benefits for disabled contributors and for survivors as well as a death benefit.

However the C/QPP was designed to replace only one-quarter of pensionable earnings up to the average industrial wage. The third layer of the retirement income system - private pension and retirement savings plans - is supposed to make up the difference.

Unfortunately **private pension plans** are riddled with problems. Their most glaring defect is their inadequate coverage: More than half the work force does not belong to a private pension plan.

Coverage is below the national average in Atlantic Canada and the Prairie provinces. Every public sector employee, but only one private sector worker in three, is covered by a private pension plan. While coverage among men is poor - just 50.6 percent of male employees have a private plan - it is even worse among women workers, only 34.6 percent of whom belong to a private plan. Part-time workers (most of them women) and the self-employed are excluded. Coverage is linked to earnings: Most upper-income employees are covered, but many middle-income earners and almost all low and modest wage earners are not members of private plans.

Coverage aside, private pension plans have several other weaknesses that render them ineffective for many of their members. Some workers lose their employer's pension contributions because they change jobs before their pension is vested. Few private plans have portability arrangements which allow employees to carry their pension credits from one job to another.

If the labor force were stable, the vesting and portability problems would not seriously weaken the private pension system. The fact is, however, that Canada has an increasingly mobile work force: The average employee now switches employers six or seven times during his or her career. As a result, even if they belong to a pension plan in every job (an unlikely state of affairs, given the low rate of pension coverage), workers typically retire with relatively small pensions. In 1981, the average male pensioner got $5,600 and the average female pensioner just $3,700 from private plans. Some private pension plan members will not even qualify for a private pension because they never worked long enough for any of their employers.

Most private pension plans do not offer sufficient protection against inflation. Pension payments decline in value as the retired person grows older, since few plans index their benefits to the cost of living. Inflation also erodes the value of the contributions on which pension payments are based. Workers in the private sector belong to plans with weaker inflation protection than those in the public sector.

Unlike the Canada and Quebec Pension Plans, most private pension plans do not provide survivor benefits. In most provinces, pension credits are not

yet regarded as family assets to be divided equally between spouses in the event of marriage breakdown. Both these failings hurt women more than men.

The problems that plague private pension plans - incomplete coverage of employees; inadequate vesting, portability, and survivor provisions; and poor protection against inflation - are reflected in the sources of the income of the aged. Our report Sixty-Five and Older found that only 11 percent of the income of unattached elderly Canadians and 12 percent of the income of aged couples comes from private pension plans.

The other part of the retirement income system's third tier - **Registered Retirement Savings Plans (RRSPs) and tax provisions which encourage saving for retirement and reduce taxes paid by the elderly** - most benefits upper-income Canadians who are already more likely to belong to a private pension plan and/or are better able to save for their retirement. Taxfilers can deduct from their taxable income (up to specified limits which, as we explain later, the February 1984 Budget proposes to raise substantially) contributions to private pension plans and Registered Retirement Savings Plans. A Pension Primer shows that these deductions are worth far more (in reduced taxes) to those with high incomes, who also are more likely to have an RRSP and/or private pension plan than low and middle-income taxpayers. Contributions to the C/QPP are tax-deductible as well - another government bonus to the well-off. The $1,000 pension income deduction, $1,000 investment interest deduction, and $2,460 exemption for aged taxfilers also reward most the minority of elderly Canadians who would enjoy comfortable retirement incomes in any case.

RRSPs do not make up for the poor coverage of private pension plans among Canadians with low and middle incomes. Eight in ten RRSP contributors enjoy above-average incomes. The highest rate of RRSP membership is among affluent professionals such as dentists (78 percent), doctors (76 percent), and lawyers and accountants (57 percent). Together, RRSPs and private pension plans cover only 49 percent of the labor force.

The Income Gap

The failure of the second and third levels of the retirement income system shows up clearly in the statistics on the incomes of the elderly.

Canada's aged - especially those who live on their own - are bunched on the lower rungs of the income ladder. Their median income is little more than half of the median income of all Canadians. Many who earn middle incomes during their working years suffer a serious drop in their living standard when they leave the labor force; we need only point to the startling statistic that half of those 65 and over qualify for the Guaranteed Income Supplement, an income security program serving the low-income aged. In fact as many as two middle-income Canadians in three can expect a reduction of at least 25 percent in their disposable income when they retire - unless the pension system is reformed.

The public parts of the pension system - OAS, GIS and the Canada and Quebec Pension Plans - cannot in their present form fulfil the anti-poverty and income-replacement objectives. Tables A through E show why.

The tables show retirement income from public sources for elderly Canadians who earned average wages or less during their working years: Eighty-six percent of women and 52 percent of men in the work force earn less than the average industrial wage. (We do not include provincial income supplements and refundable tax credits for the aged because these vary so much in value and availability from province to province). Private sources of income - private pension plans, RRSPs and other investments - are excluded since pensioners who earned low or moderate incomes before retirement receive little or no income from the third level of the pension system. Our object is to assess the retirement income available to all elderly Canadians.

The 'poverty gap' compares retirement income from public sources (OAS, GIS and C/QPP) with the low-income line for cities of 500,000 or more; figures with a negative sign indicate the number of dollars below the poverty line. The 'replacement ratio' expresses retirement income as a percentage of net pre-retirement earnings (i.e., earnings less C/QPP contributions, unemployment insurance premiums and federal and provincial income taxes). A replacement ratio of at least 75 percent is generally regarded as necessary to maintain living standards for those with average earnings or above.

Table A looks at single pensioners who earned half, three-quarters and the full average industrial wage during their career. In each case, the

pensioner falls below the poverty line (an estimated $9,900) - even the pensioner who earned the average industrial wage during his working life. Federal income security programs (OAS and GIS) provide more than half the income of single pensioners with below-average earnings. An average earner, who receives the maximum C/QPP pension ($387.50 a month in 1984), still qualifies for more than $1,000 in GIS benefits, and must get by on an income that is below the poverty line and only half of what he or she netted before retirement.

Table A

Public Pension Income, Single Pensioners, 1984

Retirement Income	Pre-retirement Earnings: 1/2 average ($11,400)		3/4 average ($17,100)		average ($22,800)	
		%		%		%
OAS	$3,220	41	$3,220	38	$3,220	36
GIS	2,140	27	1,503	18	1,089	12
C/QPP	2,549	32	3,823	44	4,650	52
Total Income	$7,909	100	$8,546	100	$8,959	100
Poverty Gap	- 1,991		- 1,354		- 941	
Replacement Ratio	81%		63%		51%	

Table B compares the public retirement income of two-earner couples with their net earnings before retirement. The first column shows a couple in which one spouse earned half and the other spouse one-quarter of the average industrial wage. Their retirement income lifts them just $283 above the poverty line, and they rely on OAS/GIS for the large part (71 percent) of their income. The second couple, whose combined earnings equal the average wage, end up only

$920 over the low-income line. The C/QPP makes up just 36 percent of their retirement income, and they qualify for $2,446 from the GIS. The third couple, with family earnings of one-and-a-half times the average industrial wage, also qualifies for GIS benefits and has a 55 percent replacement ratio that is far below the 75 percent standard.

Table B

Public Pension Income, Two-Earner Couples, 1984[6]

Retirement Income	Pre-retirement Earnings: 3/4 average ($17,100)		average ($22,800)		1 1/2 average ($34,200)	
		%		%		%
OAS	$6,440	48	$6,440	46	$6,440	43
GIS	3,083	23	2,446	18	1,395	9
C/QPP	3,823	29	5,097	36	7,199	48
Total Income	$13,346	100	$13,983	100	$15,034	100
Poverty Gap	283		920		1,971	
Replacement Ratio	70%		72%		55%	

Table C shifts to one-earner couples. As with single pensioners and two-earner couples, their retirement incomes are not far from the poverty line - even couples whose breadwinner earned the average wage - and income security programs (OAS/GIS) account for a large part of their retirement income. The replacement ratios are higher than the previous tables because the spouse without earnings qualifies for OAS and GIS benefits that add substantially to the couple's retirement income. However, fewer and fewer elderly Canadians fit the traditional one-earner couple mould; a rising proportion of the aged are either couples in which both spouses worked in the labor force, or single pensioners who are never-married, widowed or divorced.

Table C

Public Pension Income,
One-Earner Couples, 1984

Retirement Income	Pre-retirement Earnings: 1/2 average ($11,400)		3/4 average ($17,100)		average ($22,800)	
		%		%		%
OAS	$6,440	51	$6,440	48	$6,440	47
GIS	3,720	29	3,083	23	2,670	19
C/QPP	2,549	20	3,823	29	4,640	34
Total Income	$12,709	100	$13,346	100	$13,759	100
Poverty Gap	- 354		283		696	
Replacement Ratio	118%		90%		73%	

Table D shows the income of elderly surviving spouses who had been non-earner members of one-earner aged couples (i.e., widowed homemakers). Retirement income is made up of OAS, GIS and a C/QPP survivor benefit (worth 60 percent of the deceased spouse's retirement pension). The replacement ratio shows the widow's retirement income as a percentage of what she and her husband received from OAS, GIS and C/QPP before his death.

Table D

Public Pension Income, Surviving Spouse, One-Earner Couples, 1984

Retirement Income	Pre-retirement Earnings: 1/2 average ($11,400)	%	3/4 average ($17,100)	%	average ($22,800)	%
OAS	$3,220	43	$3,220	41	$3,220	40
GIS	2,650	36	2,267	29	2,019	25
C/QPP	1,529	21	2,294	30	2,790	35
Total Income	$7,399	100	$7,782	100	$8,029	100
Poverty Gap	- 2,501		- 2,118		- 1,871	
Replacement Ratio*	58%		58%		58%	

* as a percentage of the couple's retirement income

The C/QPP survivor pension contributes far less to the widow's income than OAS/GIS, even if her husband had earned the average wage. Her retirement income from public programs is only 58 percent of what she and her husband lived on before his death, and leaves her thousands of dollars below the low-income line.

Table E looks at surviving spouses from two-earner couples. The earnings of the couple at three-quarters of the average industrial wage are made up of one spouse earning one-quarter and the other spouse one-half the average. Each spouse earned half the average wage in the couple with combined earnings

equal to the average. One spouse in the third couple earned the average and the other half the average wage, for a combined income of one-and-a-half times the average. We assume the survivor had the lower earnings, except for the second couple where each earned half the average. The picture is much the same as for the survivor from a one-earner couple - a low replacement ratio and an income below the poverty line in each case.

Table E

Public Pension Income, Surviving Spouse, Two-Earner Couples, 1984

	Pre-retirement Earnings		
Retirement Income	3/4 average ($17,100)	average ($22,800)	1 1/2 average ($34,200)
OAS	$3,220	$3,220	$3,220
GIS	2,013	1,374	745
C/QPP	2,803	4,078	5,339
Total Income	$8,036	$8,673	$9,304
Poverty Gap	- 1,864	- 1,227	- 596
Replacement Ratio*	60%	62%	62%

* as a percentage of the couple's retirement income

Some people argue that future pensioners will be better off because the retirement income system will 'mature'. There is some truth to this claim, but it in no way weakens the case for major reform.

The February 1984 Budget proposes to ensure that the C/QPP's limit on pensionable earnings (currently $20,800, as opposed to an estimated average industrial wage of $22,800) reach the average wage by 1987. Raising the level of earnings on which C/QPP pensions are based will mean better benefits: the maximum retirement pension for 1984 would be about $450 a month if the year's maximum pensionable earnings already equalled the average industrial wage, instead of the current $387.50.

The Canada and Quebec Pension Plans are also maturing in the sense that more and more elderly Canadians are eligible for retirement pensions. When the plans were introduced in 1966, persons already retired were not eligible; those aged 56-69 who were still working could contribute, but they qualified only for reduced benefits upon retirement. Full pensions have been available since 1976, and each year a larger proportion of the aged population receives C/QPP cheques.

The revolutionary rise in the labor force participation rate of women - from 23 percent in the early 'fifties to 52 percent today and a forecast 71 percent by the end of this century - means that most women will retire with a C/QPP pension of their own. The Canada Pension Plan's recent adoption of the child-rearing dropout (which the Quebec Pension Plan has had since 1977) allows family allowance recipients (usually women) to drop out years during which they had children under 7 years old from the calculation of their average lifetime earnings on which their retirement pension is based. According to the Economic Council of Canada, this amendment will produce about 22 percent higher retirement benefits for the average mother.[7]

Unfortunately the Canada and Quebec Pension Plans have a built-in limitation: they will replace only one-quarter of earnings up to the average wage when they mature. As we explained earlier, the third level of the retirement income system - private pension and savings plans - is supposed to fill the gap in replacement income. However progress in expanding coverage actually has slowed in recent years, so we cannot look to private pension and savings plans in their current form to magically solve the pension problem.

Conclusion

The two Canadians in three with below-average earnings get little from the private part of the pension system. They must continue to rely on income security programs (the universal OAS and the income-tested GIS and provincial supplements) for most of their income, given the limited earnings-replacement role of the C/QPP and the unavailability of private pension and retirement savings plans. Many middle-income earners will face a serious decline in their living standard when they retire. These are the people - the low and middle-income majority of Canadians - who most need pension reform.

A Pension Primer, the companion to this report, concluded that Canada's retirement income system is out of balance. The inability of public and private pension plans to adequately replace pre-retirement earnings places undue strain on the income security programs that establish the foundation of the pension system. The Guaranteed Income Supplement serves many more elderly persons than it was ever intended to help.

Our retirement income system serves best the fortunate minority of Canadians who were well-off during their working years and who enjoy a comfortable retirement income, mainly from personal savings and/or private pension plans. The majority of retired Canadians, on the other hand, have to get by on low or modest incomes obtained largely from government income security programs and public pension plans that were not designed to achieve the income-replacement goal on their own.

ROUTES TO REFORM

Any serious proposal for reforming the pension system must come to terms with both the anti-poverty and income-replacement issues. The immediate solution to the problem of poverty among the aged can be accomplished by raising income security benefits. How to remedy the failings of the public and private pension and savings plans that make up the second and third levels of the retirement income system is a far more difficult and controversial question.

Dozens of reports on the pension system have been issued over the last several years, each with a variety of detailed proposals for reform. Our aim here is not to review every one of the many recommendations that have been made, but rather to briefly outline the major approaches to pension reform and the key arguments of their supporters and critics. Of course, not every reform package that has been put forward falls neatly into one camp or another; some - including the emerging compromise position discussed in the next chapter - blend elements from different schools of thought.

End Poverty Among the Aged

Everyone agrees that no elderly Canadian should live in poverty. Most believe that increasing the Guaranteed Income Supplement is the best way to accomplish this fundamental objective of the retirement income system.

The GIS rate has been raised (above and beyond the normal quarterly indexing to the cost of living) four times since the program began in 1967. The latest increase, announced in the February 1984 Budget, will augment the GIS rate for the single elderly and one-pensioner couples by $50 a month - $25 in July and another $25 in December of this year. Combined OAS/GIS benefits at the single rate will come to $6,634 for 1984, as opposed to $6,458 without the GIS increase.

Table F illustrates the effect of the GIS raise for single pensioners. We show benefits for December 1984, when the $50 increase will be fully implemented. (Figures have been rounded to the nearest dollar).

Table F

Maximum OAS/GIS Benefits,
Aged Singles and Couples, December 1984

	Single Person	Couple	Single/Couple
Before Budget	$549	$ 972	56%
After Budget	600	972	62
Poverty Line	825	1,089	76
Poverty Gap	- 225	- 117	

Without the increase announced in the Budget, single pensioners receiving OAS and GIS at the maximum rate would receive $549 a month, leaving them $276 below the monthly low-income line for a metropolitan center. (We estimate the 1984 low-income lines at $9,900 for one person and $13,063 for a couple living in a city of 500,000 or more, which translate into $825 and $1,089 a month, respectively). The GIS raise closes the poverty gap by $50 a month for singles, though they will still remain farther below the low-income line than elderly couples ($225 below, as opposed to $117 for couples). By limiting the GIS increase to singles, the Budget will lift their combined OAS/GIS benefits from 56 percent to 62 percent of a couple's income guarantee. Studies have shown that a single person needs about two-thirds the income of a couple, so the $50 increase will improve the situation of single aged Canadians vis-ã-vis pensioner couples.

Provincial income supplements for the aged (reviewed in A Pension Primer) close the poverty gap further. In Alberta, for example, a low-income single pensioner will receive $600 a month from Ottawa and another $95 a month from the provincial government, for a total of $695. This benefit is $130 under the low-income line for Calgary and Edmonton, as opposed to $225 below without the Alberta supplement. However four provinces - Newfoundland, Prince Edward Island, New Brunswick and Quebec - do not provide income supplements for the aged. Among the provinces and territories that do, benefits range from $188 a year for the single aged in Manitoba to $1,200 for single pensioners in the Yukon.

The best bet for Canada's elderly poor - especially the large and growing number who live alone - is additional improvements in the Guaranteed Income Supplement to assure them an income equivalent to the low-income line. However the poverty problem among Canada's aged cannot be solved simply by increasing GIS benefits. Too many pensioners (half the elderly population) receive the Guaranteed Income Supplement because of the failure of the second and third levels of the retirement income system. Major reforms to the C/QPP and/or private pension and savings plans are required to reduce the number of elderly poor and so make further improvements in GIS benefits more financially feasible.

Reforming Pensions: Public or Private?

The second and third levels of our retirement income system are supposed to enable Canadians to put aside part of their earnings for their retirement. Most experts agree that public and private pension and retirement savings plans fail to replace sufficient income for much of the work force. Where critics differ, however, is on how best to remedy this situation.

There are three major schools of thought on how to reform Canada's pension system. Two approaches hinge on improvements to private pensions, while the third favors an expansion of the role of the Canada and Quebec Pension Plans.

a) regulatory reform

Proponents of regulatory reform take a philosophical stance that sets them apart from the other two approaches. Ensuring an adequate income in retirement is seen as primarily a personal responsibility of individuals, who are supposed to save during their working years in preparation for retirement. This position opposes any further government interference in the pension arena other than legislating improved standards for private pensions. Most important of all, membership in private pension plans should remain voluntary; in their view there is enough compulsion in the pension system already with the mandatory Canada and Quebec Pension Plans. Individual initiative, not government-imposed compulsion, is seen as the right road to pension reform.

Supporters of this position - prominent among them the business community, the federal Department of Finance, and most provincial governments - believe that no radical changes are required in the structure of the existing pension system. All that is needed are improvements in private pension standards to solve the problems involving vesting, portability, inflation and survivor benefits. The growth of coverage under private pension and retirement savings plans is seen as a satisfactory way of achieving the income-replacement goal.

Private pension plans are regulated by government legislation. The federal Pension Benefits Standards Act applies to private pension plans covering one million employees in the federal civil service, Crown corporations, banking, transportation and communications industries, and the Yukon and Northwest Territories. However most members of private plans - 3.5 million - fall under provincial pension legislation; all provinces except for Newfoundland, Prince Edward Island and British Columbia have such laws. Pension standards set minimum requirements which private plans must meet. The object of regulatory reform is to improve these standards.

Earlier **vesting** would go a long way towards cutting the pension losses for employees who change jobs several times during their career. The current standard requires vesting of the employer's pension contributions after an employee accumulates 10 years of service with his employer and has reached the age of 45. Pension contributions so vested are also **locked-in** by law, which means that plan members cannot obtain a refund of their contributions if they switch employers, and thus are assured a pension when they retire.

The Business Committee on Pension Policy, representing thirteen major Canadian business and professional associations covering a broad spectrum of the private sector, has developed a consensus position in support of regulatory reform. The Committee recommends locked-in vesting after 5 years of service and age 30, or after one year of service so long as age and service total 45 years.[8]

Manitoba recently amended its pension standards legislation to require vesting after 10 years of service, regardless of age, though the locking-in rule does not apply until age 45. Starting in 1985, locked-in vesting will be

required after 5 years and, from 1990 on, after just 2 years. Saskatchewan now requires locked-in vesting for members who have worked for an employer at least one year and whose age and employment in the province total at least 45 years.

There is also consensus on the goal of **portability** in the private pension system so that mobile employees can take their pension credits to their new employer and have them transferred into his pension plan. Some pension experts urge the development of portability agreements among employers within the same industry - an approach already being used in the public sector, universities, the life insurance industry and the construction industry. However there were at last count 14,586 private pension plans in Canada, so the inter-employer agreement approach is not a feasible solution to the portability problem in general.

Rather than negotiating a myriad of complex agreements among individual employers, a more practicable solution might be to establish a new registered retirement savings vehicle. No matter where an employee moved (whether to another employer, out of the labor force or into the self-employed category), he could carry his vested pension credits with him in such a personal savings plan. The federal Green Paper on pension reform urged the creation of such a scheme, which it called a Registered Pension Account (RPA).[9] Unlike an RRSP, the RPA would accept employer contributions on behalf of the employee and credits would be locked-in until retirement.

A major weakness of private pension plans is their lack of sufficient protection against **inflation**. As we explain in <u>A Pension Primer</u>, inflation erodes the value of both pension credits before retirement and pension benefits after retirement. There has been a good deal of disagreement on how to tackle this problem because employers are wary of the extra cost that reform would entail.

One solution is the 'excess interest indexing' method whereby pension benefits would be adjusted according to the actual investment earnings on pension fund assets over and above a 'floor' rate of return. The Green Paper cited a proposal from the Canadian Association of Pension Supervisory Authorities. Pension benefits, deferred pensions and accrued pension credits

would have to be increased each year by a specified inflation adjustment factor to be published each year by the federal government - the difference between the 'guide rate' (the average yield on long-term Canada bonds over the last five years) and a 'base rate' of 3.5 percent (which is the approximate rate of return that pension funds can be expected to earn if there were no inflation). For example, if the five-year average return on long-term Canada bonds were 11 percent, then pension benefits would be indexed each year by 11 percent minus 3.5 percent, or 7.5 percent.

The Parliamentary Task Force on Pension Reform suggested that pension benefits be indexed according to the annual rise in the Consumer Price Index, less 2.5 percent. Such increases would be limited by the lesser of two measures of ability to pay: a ceiling representing the financial performance of pension funds, and a ceiling measuring the current productivity of the economy.[10]

Most private sector representatives oppose the idea of compulsory inflation protection for private pension plans. The Business Committee on Pension Policy attacked the Green Paper's excess interest proposal as a costly imposition on employers, and argued that inflationary adjustments should remain a voluntary decision on the part of the employer, preferably encouraged by new tax incentives.

Proponents of regulatory reform also acknowledge that changes are needed to provide **protection for spouses** of pension plan members. Three items have been singled out for attention - the splitting of pension credits when spouses break up; the provision of survivor benefits; and prohibiting the termination of survivor benefits when a recipient remarries.

There is general agreement that, as is the case in the Canada and Quebec Pension Plans, pension benefits accumulated during a marriage (or a common-law relationship recognized by provincial family law) should be divided equally between the spouses in the event of marriage breakdown. The next chapter discusses the federal government's plans to amend its pension standards to effect this reform, and some provinces - British Columbia, Alberta, Saskatchewan, Manitoba and New Brunswick - now recognize credit-splitting upon marriage dissolution in their family law.

With the exception of Saskatchewan and Manitoba, pension standards laws do not require plans to provide survivor benefits. The Green Paper on pension reform recommended that all private pension plans, RRSPs and the proposed Registered Pension Accounts have to provide a retirement benefit in the form of a 'joint and last survivor annuity', which means a retirement pension that is actuarially reduced in order to provide a survivor benefit. (Spouses could opt in writing for an alternative to the joint and last survivor annuity). The survivor benefit would be at least 60 percent of the initial retirement benefit.

Saskatchewan recently amended its Pension Benefits Act to require plans that do not provide survivor benefits to provide a joint and last survivor pension; unless the surviving spouse has signed a waiver to the contrary, he or she must receive a survivor benefit equal to at least half of the retirement benefit. Manitoba has adopted a similar provision, except that the surviving spouse must get two-thirds of the joint and survivor benefit and the latter can only be waived if both spouses agree.

Quebec has just done away with a rule that terminated Quebec Pension Plan survivor benefits for recipients who remarry. Ottawa proposes to follow suit for both the Canada Pension Plan and private pension plans governed by federal pension standards. The latter change, like the requirements for credit-splitting and survivor benefits, aims to give private pension plans some of the advantages of the Canada and Quebec Pension Plans.

Such regulatory reforms to strengthen private pension plans are necessary and long overdue. The federal Department of Finance estimates that the package of regulatory improvements proposed in the February 1984 Budget (reviewed in the next chapter) would increase the overall amount of pension income by 15 to 20 percent at a combined employer/employee cost of between 1.1 and 1.5 percent of payroll. Members working in the private sector would benefit even more - total pension income could rise by 20 to 25 percent in the long run - because their existing plans tend to be weaker than pension plans for public sector employees.[11] Better spousal benefits would help married and divorced women; measures to deal with the vesting, portability and inflation

problems would help women in general since they change employers more often than men and draw pension benefits longer because they tend to live longer than men.

Unfortunately, these changes will just affect people who already belong to private pension plans. Most women do not. Most private sector workers do not. Most below-average earners do not. **The fly in the ointment of regulatory reform is that it only helps the minority of Canadians - most of them with above-average incomes - who are members of private pension plans.**

The regulatory approach to reform cannot deal with the fatal flaw of private pension plans - their woefully inadequate coverage of the work force. Indeed, the decision to rely solely or largely on regulatory reform of the pension system will **increase** the gap between the minority who have private pensions and the majority who do not.

Some critics also worry about employers' response to the cost of regulatory reform. Employers who sponsor pension plans likely will pass these additional expenses on to their employees through lower wage settlements and/or will weaken the benefit formula of their plans.

Not only is regulatory reform incapable of coming to terms with the key issue of coverage, but it could make this problem even worse. The extra expense due to stricter pension standards (especially inflation protection) could discourage some employers from setting up pension plans and even lead some to drop their plans. This possibility is especially discouraging since small employers - who tend to employ a larger proportion of lower-wage workers and are less capable of bearing the administrative and contributory expense of private plans - are even less likely to establish a private plan that would be subject to stricter pension standards. Large employers, on the other hand, are in a much better position to cope with tougher pension standards because they already offer pension plans that more closely approximate or match the standards of regulatory reform.

b) mandatory private pensions

In view of the deficiencies of regulatory reform, some advocates of the private route to pension reform have argued for mandatory private plans.

All employers would have to provide pension plans, and all employees would be required to join them.

The Canada and Quebec Pension Plans would continue to replace 25 percent of earnings up to the average industrial wage. However the third level of the retirement income system in effect would be split into two parts - mandatory private pensions for all workers to replace an additional portion of earnings, and voluntary private pension and savings plans for those with the desire and money to increase further their income upon retirement. The C/QPP and mandatory private pension plans together would guarantee all pensioners a better level of replacement income than at present.

The Canadian Life and Health Insurance Association proposed a mandatory scheme in 1981. It would require all employers to provide a private pension plan covering earnings from 50 to 150 percent of the average industrial wage for all employees over age 25. The plan would have to replace 30 percent of earnings between one-half and the full average industrial wage, and 55 percent of earnings from the average to one-and-a-half times the average.[12]

Plans would be required to lock-in and vest pension credits and to provide a survivor benefit of two-thirds of a retirement pension. Pensions would be increased each year to reflect the fund's investment earnings over 3 percent. Employers would be free to choose their plan, so long as it met the pension standards.

The Ontario Royal Commission on the Status of Pensions also recommended a mandatory approach to pension reform. Entitled 'PURS' (Provincial Universal Retirement System), this proposal is a variant on the Registered Retirement Savings Plan. Every Ontario worker between the ages of 18 and 64 would have to join the scheme unless he or she already belonged to a private plan that provided at least equivalent benefits. Employers would contribute 2 percent of contributory earnings, while employees' contribution rates would depend on their age (1 percent for those 18 to 30, 1.5 percent for those 30 to 45, and 2 percent for workers aged 45 to 65); contributory earnings would be the same as in the C/QPP (i.e., between the year's basic exemption and the year's maximum pensionable earnings). Contributions would be vested and locked-in. The individual worker would choose an institution to invest his or her PURS

money (e.g., a trust company, credit union, life insurance company or a new central pension agency to be established by the Ontario government) and would carry the PURS plan from job to job.[13]

PURS would solve the coverage problem, but its income-replacement capacity is questionable. It is not at all certain that the scheme would be able to deliver the 25 to 30 percent of earnings up to the average wage that its designers intended.

Almost all private pension plan members belong to 'defined benefit' plans which promise a pension based on years of service and, usually, earnings. An example is a plan which calculates the pension payment as the number of years of pensionable service, to a maximum of 35, multiplied by 2 percent of average earnings during the member's 6 best-paid consecutive years. PURS, on the other hand, is a 'defined contribution' or 'money purchase' savings plan in which contributions are fixed and the eventual pension is the retirement annuity that can be bought with the contributions plus interest built up in the fund.

Critics point out that PURS would place all the risks on the individual worker's shoulders. His pension would depend on the performance of the particular investment vehicle he chooses (which is also affected by inflation) and the annuity rates in effect when he retired (since he must purchase an annuity with his PURS money upon retirement). His pension's actual replacement value would depend on the relative movement of pension investment returns and wages during his career. Unfortunately the employee has little if any control over these complex economic factors, so the claim that the PURS scheme would realize the ethic of 'individual responsibility' rings hollow. Employees with identical earnings and PURS contributions could end up with very different retirement benefits depending on their particular savings plan's financial performance.[14] These failings led one critic to liken PURS to a lottery - "the Wintario of pension systems".[15]

Another criticism of the mandatory private school of pension reform is its impracticality. It would prove complicated both from an administrative and legislative point of view. Detailed federal-provincial agreements would be required to avoid variations from one province to another in the pension standards that governed mandatory schemes. Full, nation-wide portability (an

advantage of the C/QPP) would be difficult to achieve under a mandatory approach that permitted a variety of plans. Small employers - few of whom offer private pension plans at present - could find the financial and administrative burden of mandatory pensions onerous; they would object to the mandatory approach as an additional, unwarranted intrusion into their affairs by government. It would take many years to phase in mandatory pension (47 years in the case of the PURS scheme) - time that today's workers can ill afford.

In fact the mandatory approach to pension reform has won little support. The Business Committee on Pension Policy (one of whose members is the Canadian Life and Health Insurance Association, whose proposal for mandatory pensions we mentioned earlier), has opted for regulatory reform and rejected mandatory reform. The two national organizations for small business - the Canadian Federation of Independent Business and the Canadian Organization for Small Business - have attacked mandatory pensions as a recipe for financial disaster for small employers who have been struggling to survive the recession and cannot afford additional employee benefits. For quite different reasons, to which we now turn, the mandatory private approach also is dismissed by supporters of an expanded Canada/Quebec Pension Plan.

c) **expanding the C/QPP**

The third route to pension reform is through strengthening the Canada and Quebec Pension Plans. The heart of this approach is an expansion of the plans to replace a larger proportion of pre-retirement earnings. We also review additional improvements that could be made whether the C/QPP were expanded or not.

(i) expansion

Organized labor and most women's, pensioner and social welfare organizations doubt that either regulatory reform or mandatory private plans can provide a satisfactory solution to the pension problem. They favor instead an expansion of the Canada/Quebec Pension Plan beyond the current limit of one-quarter of earnings up to the average industrial wage. Proposals vary, but most recommend a doubling of the C/QPP's income-replacement capacity to half of pensionable earnings up to the average industrial wage.

There are strong arguments in favor of expanding the Canada/Quebec Pension Plan. It is universal by design, covering all types of workers - employees and the self-employed, those who work part-time as well as those who work full-time, recent entrants to the labor force and those who have worked for a long time, and workers at all earnings levels. The C/QPP provides locked-in vesting and truly portable pensions; no matter how many times workers switch employers, what part of the country they live in or what their work history, their and their employers' C/QPP contributions go with them. The C/QPP offers a comprehensive package of benefits; in addition to the basic retirement pension, there are survivor, orphan, disability and death benefits administered by the same plan. Both pension credits and benefits are fully indexed against inflation, an accomplishment that would appear to be next to impossible under any of the proposals for improving private plans. C/QPP contributors are assured a pension equal to a fixed proportion of their lifetime pensionable earnings.

Not only does the C/QPP offer superior design features - universal coverage, vested and portable contributions, and fully indexed credits and benefits - but its expansion could be phased in relatively quickly. The plan has been in existence long enough to have won the trust and acceptance of most Canadians. Its administrative apparatus, already in place and working efficiently, could at little extra cost accommodate the minor changes required to implement expanded benefits. Ironically, an expansion of the C/QPP would require no further intrusion of government into the private sector (since all employers already contribute to the plan on behalf of their employees), whereas the mandatory private approach to pension reform would require a new form of government monitoring and extra paperwork for employers, especially those who do not now offer pension plans.

Opponents of an expanded Canada/Quebec Pension Plan cannot deny the obvious practical advantages this approach offers over regulatory reform and mandatory privative pension plans. They object to an enlarged public pension system because they charge it would disrupt the economy, threaten economic recovery and pose a cost burden that future generations would be unwilling to bear.

Supporters of an expanded C/QPP say that the question of whether we can afford a better retirement income system is as much a political as economic issue. The current system clearly does not adequately meet its anti-poverty and income-replacement objectives, and continued growth in the aged population will magnify its inadequacies in future. They believe that Canadians are willing to pay the higher contribution rates that an enlarged C/QPP would require in order to ensure a decent income when they retire. They throw the cost question back at those who complain that the nation cannot afford major pension improvements: the real issue is can we afford **not** to reform the pension system?

No more convincing are the claims that an expanded C/QPP would wreck the private pension industry, disrupt financial markets, discourage personal savings and place far too much economic power in government hands. Expansionists do not want to put private pension and retirement savings plans out of business or end the use of pension funds as a source of investment capital. An expanded C/QPP would only cover earnings up to the average industrial wage, leaving ample room for the private level of the pension system to continue to meet the retirement income needs of the one-third of Canadians with earnings above the average.

The Economic Council of Canada concluded that the Canada/Quebec Pension Plan has not depressed levels of personal savings.[16] After a careful scrutiny of the evidence, the Canadian Labour Congress found no substance to the accusation that a pay-as-you-go public pension plan hampers savings, investment and economic growth.[17] Under a pay-as-you-go financing system, current contributions pay for current benefits and administrative costs and can provide a contingency reserve to protect against unexpected short-term fluctuations in revenues or expenditures. The National Council of Welfare's report <u>Financing the Canada Pension Plan</u> recommended that the Canada Pension Plan be shifted from the current system of partial funding (under which contributions have exceeded expenditures and therefore produced a surplus, most of which is loaned to the provinces) to pay-as-you-go financing. Such a change would minimize the contribution increases required to pay for an enlarged C/QPP and do away with a large reserve fund, thus rendering baseless the fear that expansion would lead to a dangerously large pool of investment capital in the hands of government.

Whether the Canada/Quebec Pension Plan is expanded or not, contribution rates are going to have to rise anyway to keep the plan financially viable in the face of increasing pension claims from Canada's rapidly growing retired population. The existing contribution rate, which is 3.6 percent for combined employer/employee contributions and for the self-employed, will have to increase to an estimated 9 to 10 percent over the next fifty years. Doubling C/QPP benefits and implementing other C/QPP improvements proposed in the Green Paper on pension reform (discussed later in this chapter) would require a contribution rate of about 20 percent by the year 2030. An employee would pay about 10 percent of earnings up to the average industrial wage, as opposed to 1.8 percent at present. The financial burden of such an increased contribution rate for lower-income workers could be eased by raising the year's basic exemption or replacing the tax deduction for C/QPP contributions with a tax credit.

C/QPP expansionists point out that the contribution rate required to finance a strengthened plan is low by international standards. A number of West European countries with much larger aged populations provide better public pensions which, in turn, require larger contributions. In 1979, public pension contribution rates (employer and employee combined) were 24.7 percent in Norway, 20.3 percent in Sweden, 19.5 percent in Austria, 19.0 percent in the Netherlands, 18.0 percent in West Germany, 14.0 percent in Belgium and 12.9 percent in France. These economies have fared no worse than and in some cases better than ours, so the argument that a larger C/QPP would place an intolerable burden on the Canadian economy has more scare tactic value than substance.

The notion that major pension reform threatens economic recovery is alarmist. C/QPP contribution rates would be gradually and predictably increased over many years, allowing the economy time to adjust. The Parliamentary Task Force on Pension Reform recommended that CPP contribution rates be scheduled for a 25-year period starting in 1985, with provision for review every five years to allow for any necessary adjustments.

While a strengthened C/QPP would cost Canadians more as contributors, it would save them money as taxpayers. Fewer pensioners would have to rely on the Guaranteed Income Supplement, Spouse's Allowance and provincial income

supplements and welfare payments. The federal and provincial governments now provide a complex array of tax concessions, subsidies and services to help compensate for elderly citizens' inadequate incomes (these measures are reviewed in A Pension Primer): A stronger C/QPP would reduce or eliminate the need for some of these programs and services. Governments also would gain additional tax revenue from higher pensioner incomes.

Critics of pension expansion often raise the spectre of demographic doom, warning that the inexorable growth in the elderly will gobble up more and more of society's resources and place an intolerable burden on our children and grandchildren. If we raise contribution rates to pay for an expanded C/QPP, so the argument goes, future generations might balk at sacrificing their earnings to support a large elderly population.

Our report Sixty-Five and Older examined this doomsday scenario and judged it to be exaggerated and one-sided. Today there are 17 aged Canadians for every 100 of working age. This ratio will continue to increase gradually for the next thirty years, then will escalate rapidly from a projected 22 (seniors per 100 persons 20 to 64) in 2011 to 36 per 100 by 2031. However this figure will decline after 2031 as the elderly population begins to decrease.

We must also take into account the ratio of young Canadians to those of working age. The youth dependency ratio has dropped significantly since 1961. Today there are 55 young Canadians for every 100 aged 20 to 64. The ratio will continue to decrease to about 44 in 2011 and then remain in the mid-forty range until mid-century.

Thus the elderly will exert their greatest pressure on the economy for a critical but limited twenty year period between 2011 and 2031; the situation will ease somewhat thereafter. The continued decline in the ratio of young people to those of working age during the next thirty years will partly offset the rise in the old age dependency ratio because the young also require their share of both public and private resources.

Supporters of an expanded Canada/Quebec Pension Plan see the growth in the aged population as an argument for, not against, an improved pension

system. An enlarged C/QPP would take some of the pressure off income security programs, and the patchwork of subsidies and services that have been developed to help compensate for the inadequate incomes of so many retired Canadians. Those who argue that tomorrow's workers will refuse to pay the higher C/QPP contributions required to provide today's workers a decent pension not only have a pessimistic view of the bond between the generations, but forget that future workers will also want a decent income when they retire. Besides, the elderly will be a potent political force to reckon with in future that can fight to ensure that the pension promise is kept.

(ii) other improvements

There are other ways the Canada and Quebec Pension Plans could be improved. Some people support these changes even though they oppose expanding the plans to replace a larger share of pre-retirement earnings.

The year's maximum pensionable earnings (YMPE) is being increased each year by 12.5 percent until it reaches the level of the average industrial wage, after which it will be indexed to the latter each year. Currently the average industrial wage (an estimated $22,800 for 1984) is $2,000 above the YMPE ($20,800). If the two were equal, the maximum C/QPP retirement pension for 1984 would be $450 a month instead of the actual $387.50, or 16 percent higher. A number of groups have recommended that the catch-up timetable be accelerated so that the YMPE equals the average industrial wage within two or three years.

C/QPP credits earned during the course of a marriage can be split between spouses only upon marriage breakdown. This credit-splitting feature could be applied when spouses have been separated for three years, when the younger spouse reaches 65, when either spouse dies, or when a non-earner spouse (or the lower wage earner in a two-earner couple) becomes disabled.

Some groups favor a C/QPP 'homemaker pension'. The Parliamentary Task Force on Pension Reform proposed such a scheme for persons who work only or mainly in the home caring for a spouse, a child under 18, or a dependent and infirm adult relative. The pension would be based on half the year's maximum pensionable earnings.

Survivor benefits under the C/QPP should be improved. (The QPP already pays better benefits to survivors under 65 than does the CPP). The Green Paper suggested that the current CPP survivor benefit for spouses 65 and older be replaced by a lifetime continuing pension equal to 60 percent of the deceased spouse's retirement pension (after credit-splitting). Taking into account the earlier proposal for credit-splitting, the elderly survivor would receive 80 percent of the CPP benefits that were coming into the household before the other spouse died.

The Green Paper put forward for discussion a two-part benefit for survivors under 65. The CPP would provide a 'continuing benefit' equal to the survivor benefit for those 65 and older (i.e., 60 percent of the split pension accrued to date), and a 'bridging benefit' equal to the Old Age Security benefit for three years or until age 65, whichever was shorter. Survivors with children would get the bridging benefit for a longer time (e.g., until the youngest reached 7).

The Canada Pension Plan stops survivor benefits when recipients remarry, but the Quebec Pension Plan eliminated this practice this year. Many feel the Canada Pension Plan should follow suit. The CPP also could be amended to provide greater flexibility in retirement age. The QPP now allows contributors to draw an actuarially reduced retirement pension as early as age 60 or an actuarially increased pension up to age 70.

The C/QPP allows contributors to drop out 15 percent of their lowest earning years on which their retirement pension is based. The Parliamentary Task Force on Pension Reform recommended that this dropout provision be increased to 25 percent of the lowest earning years. This change would benefit contributors whose lifetime career average is pulled down by periods of low earnings because of unemployment or low-wage jobs.

THE 1984 BUDGET: PART-WAY PENSION REFORM

After years of study and debate, the pension reform process has finally progressed from words to action. Unfortunately the path chosen - strengthening but not expanding public and private pension plans - is in our view the least satisfactory approach to lasting reform.

The Federal Pension Package

The federal government presented its "Action Plan for Pension Reform" in the February 1984 Budget. The package contains three elements: regulatory reform of private pension plans; changes in the tax benefits for contributors to registered pension and retirement savings plans; and improvements to the Canada Pension Plan and the Guaranteed Income Supplement.

(i) regulatory reform

Ottawa has proposed amendments to the federal Pension Benefits Standards Act which regulates private pension plans covering one million employees in the federal civil service, Crown corporations, banking, transportation and communications industries, and the Yukon and Northwest Territories. The tougher standards, to take effect no later than January 1, 1987, will tackle the classic private pension problems of inflation, vesting, portability and survivor benefits. The reader must keep in mind that these proposals apply only to private pension plans within federal jurisdiction, although Ottawa wants the provinces to amend their pension standards in a similar fashion.

Private pension plans falling under federal jurisdiction must annually index retirement pensions and deferred pensions by 60 percent of the increase in the Consumer Price Index, to a maximum of 8 percent. A plan will be allowed to use a different indexing method so long as it produces equivalent or better inflation protection. Thus private plan members who retire after 1986 will be guaranteed a retirement benefit that only partly keeps up with the increase in the cost of living each year; current pensioners and members who

retire during the next three years will receive no such assurance, though the Budget exhorts plan sponsors to provide pension increases for these people "wherever financial circumstances permit".

The federal proposals also call for locked-in vesting after two years of participation in a private pension plan; there will be no age requirement. This standard is a marked improvement over the current minimum requirement for vesting after 10 years of service and age 45.

Members who switch employers will have three options: They can transfer their vested benefits to the newly created Registered Pension Account (a personal retirement savings vehicle that will operate like an RRSP that accepts employer contributions on behalf of an employee and locks in benefits until retirement) or to the next employer's pension plan, if the employer is willing. They can leave their pension credits with their former employer as a deferred benefit (subject to the 60 percent-of-CPI rule described above) which will be available when they retire. Or they can transfer their own pension contributions plus interest to a Registered Pension Account and leave a deferred pension (based on the employer's contributions) with their former employer. To ease the administrative burden of managing a large number of deferred pensions, employers will be permitted to require departing employees with pension credits under a specified minimum value (e.g., $2,000) to transfer them into a Registered Pension Account. In addition, pension plan sponsors will have to pay interest at a minimum rate (which will be set later) on the accumulated contributions of departing members of defined-benefit plans.

The Budget calls for several measures which will benefit women in particular. Pension credits and pensions already being paid will be split equally between spouses in the event their marriage or common-law relationship breaks down, unless the spouses or courts arrive at a different arrangement. All plans falling under federal jurisdiction must provide a survivor benefit of at least 60 percent of the retirement pension (the latter in the form of a joint-and-last survivor annuity). If a member dies before retirement, his or her spouse will receive a survivor benefit equal to the amount the deceased would have received when leaving an employer, to a maximum of the value of an immediate 60 percent survivor pension. Survivor benefits will no longer be

terminated if the recipient remarries. Money-purchase pension plans and individual savings plans (RRSPs and the new Registered Pension Account) will have to ensure equal pension benefits for men and women retiring in identical circumstances.

In a bid to improve coverage, membership will be compulsory for part-time as well as full-time employees "where pension plans exist for a particular occupational group". Regular part-time workers in the covered occupational group with at least three years of service will have to join the plan at age 25, if "they work at least 50 percent of the normal work period". Full-time employees 25 years and older will have to join after one year's service. These rules will not apply to occupational groups without private pension plans or to part-time workers employed less than half the normal work week - in both cases, predominantly below-average earners.[18]

(ii) tax incentives

The second aspect of Ottawa's pension package concerns tax assistance for retirement saving. Under the current system, a member can deduct up to $3,500 worth of contributions to a private pension plan each year from his or her taxable income. If he or she also contributes to an RRSP, the member is allowed to deduct 20 percent of earnings up to $3,500, less the amount contributed to a private pension plan. An RRSP contributor without a private pension plan can deduct up to $5,500 a year from his or her taxable income.

The February 1984 Budget announced a major revision and enrichment of tax breaks for contributors to private pension and retirement savings plans. (These proposals are complex; the reader should consult the Budget document "Improved Tax Assistance for Retirement Saving" for a complete account). The aim of the proposed tax assistance scheme is to encourage savings for a retirement pension equal to 2 percent of earnings accumulated throughout a working career (ages 18 to 70). To pay for such a pension, the Department of Finance reckons that an individual must contribute (or have contributed on his behalf by an employer) 18 percent of total lifetime earnings. Each year, a taxfiler will be allowed an income tax deduction of up to 18 percent of career earnings to date, less previous pension and retirement savings contributions.

The tax deduction will apply to contributions to private pension and savings plans, including the new Registered Pension Account. A taxfiler will be able to carry forward unused deduction entitlement from one year to another.

The proposed system will be phased in over several years. The first stage will see the annual limit for contributions to RRSPs and money-purchase pension plans increase from the current $5,500 (for contributors without RPPs) to $10,000 in 1985, $12,000 in 1986, $14,000 in 1987 and $15,500 in 1988. The $3,500 ceiling on deductible contributions to defined benefit private pension plans (which cover 95 percent of members) will be eliminated, though the existing limit on RRSP contributions ($3,500 less contributions to a private pension plans) will remain.

The second phase, starting in 1988, will impose a new comprehensive deduction limit of 18 percent of updated career earnings, to a maximum of $15,500, for contributions to registered pension and retirement savings plans. Pension and contribution limits will be indexed annually to the average industrial wage from 1989 onwards.

(iii) <u>better public pensions</u>

The federal government also plans improvements to the public levels of the retirement income system. The Guaranteed Income Supplement for single pensioners and one-pensioner couples is slated to increase by $50 a month by the end of 1984 ($25 in July and another $25 in December). Pensioners who receive partial OAS benefits because they have not lived in Canada for at least 40 years after age 18 - most of them immigrants - will be eligible for extra GIS benefits to bring their combined OAS/GIS basic income up to the level guaranteed to other Canadians 65 and over.

Ottawa will ask the provinces to approve measures to strengthen the Canada Pension Plan. The current provision for equal division of pension credits upon divorce will be extended to separations as specified in the Divorce Act and to common-law unions, and both parties to a divorce will be notified of their credit-splitting right. Credit-splitting will occur automatically when the younger spouse turns 65. Survivor benefits will no

longer be cut off when the recipient remarries (the Quebec Pension Plan has already enacted this amendment). Currently the year's maximum pensionable earnings is increased by 12.5 percent each year; this formula will be amended to ensure that the YMPE reaches the average industrial wage by January 1, 1987.

The pension debate has produced additional proposals to change the Canada and Quebec Pension Plans. These suggestions include a homemaker pension, improvements to disability and survivor benefits, greater flexibility in retirement age, and an increase in the period of low earnings that can be excluded when calculating benefits. The federal government has promised to discuss these ideas - some of which are contentious - with the provinces and others involved in pension reform.

The Provincial Role in Pension Reform

The federal government must negotiate its pension reform package with the provinces. The proposed changes to the Pension Benefits Standards Act will benefit the one million members of private pension plans that come under federal jurisdiction; Ottawa will try to get the provincial governments to amend their pension legislation (covering three-and-a-half million members) in a similar fashion to promote national uniformity of pension standards. Changes to the Canada Pension Plan require the approval of two-thirds of the provinces with two-thirds of the population, a rule that makes Ontario's acceptance crucial since it wields a veto. Ottawa also must seek Quebec's cooperation in making similar changes to the Quebec Pension Plan to maintain parallelism between it and the Canada Pension Plan. In addition to the amendments and proposals to the Canada Pension Plan noted earlier, federal-provincial agreement must be reached on how to schedule increases in the CPP contribution rate to pay for current and proposed benefits.

The Treasurer of Ontario, the Honourable Larry Grossman, previewed his government's position on pension reform in two speeches delivered just before the February 1984 federal Budget. Ontario rejects both the mandatory approach recommended by its Royal Commission on Pension Reform and expansion of the Canada Pension Plan, opting instead for regulatory reform of private pensions and encouragement of voluntary personal savings for retirement. The

province promises improvements in its pension standards for vesting, portability, inflation protection and survivor benefits.

Mr. Grossman proposed the same indexation formula for private pension plans - 60 percent of the increase in the cost of living - as the federal Minister of Finance in his Budget delivered three days later. The two governments also agree on a 60 percent survivor benefit, equal division of pension credits and benefits upon marriage breakdown, and a locked-in personal retirement savings vehicle that accepts employer contributions. Ontario prefers vesting after five years and locking-in of vested pension contributions once a member reaches age 40, whereas Ottawa proposed locked-in vesting after just two years with no age requirement.

Ontario also supports improvements to the Guaranteed Income Supplement and Canada Pension Plan. It will complement the $50 GIS increase for single pensioners by raising its provincial income supplement by $34 for those receiving GIS at the single rate. The province endorses credit-splitting of CPP benefits when the younger spouse turns 65. Ontario also wants increases in CPP disability and survivor benefits.

Clearly, then, Ottawa and Toronto appear to be travelling the same road to pension reform. Ontario's Treasurer plans to chair a meeting of provincial ministers responsible for pension reform in June of 1984, with the object of establishing federal-provincial concensus on private pension reform by summer and legislating uniform pension standards amendments within the year.

Saskatchewan and Manitoba already have improved their pension standards. The other provinces likely will follow the path of regulatory reform. Quebec will stake out its position in a forthcoming White Paper; if a recent speech by its Social Affairs Minister is any indication, Quebec will pursue a similarly cautious, non-expansionist path to pension reform.[19]

The Other Actors

The business community is concerned about the cost of stricter pension standards, particularly the federal proposal that pension payments and deferred

pensions be indexed to 60 percent of the annual increase in the Consumer Price Index. Some employers are not enthusiastic about compulsory coverage of part-time workers in existing pension plans and earlier, locked-in vesting of pension contributions. However they find the alternatives - mandatory private pension plans or expansion of the Canada/Quebec Pension Plan - much more objectionable, so the private sector has little choice but to go along with governments' push to regulatory reform.

Organized labor, women's organizations, and social welfare groups have fought for expansion of the Canada and Quebec Pension Plans throughout the debate on pension reform. However with the exception of the Canadian Labour Congress, and a few journalists, little has been heard from the pro-C/QPP expansion forces since the February Budget. As a result, the apparent victory of the regulatory approach to pension reform has gone largely unopposed and almost unnoticed.

Who Will Benefit?

Regulatory reform will improve Canada's pension system. Unfortunately, it is only a partial remedy that cannot mend the Achilles' heel of private pension and retirement savings plans - their inadequate coverage of the work force and bias towards higher-income earners. In fact the "Action Plan for Pension Reform" announced in the February 1984 federal Budget can only widen further the gap between the minority of better-off Canadians who can look forward to a comfortable income from private pensions and retirement savings plans, and the low and middle-income majority who must continue to rely heavily on public pension plans that, even with the improvements proposed in the Budget, cannot provide an adequate retirement income.

(i) regulatory reform

The changes advocated by both the federal and Ontario finance ministers will do little to improve coverage of private pension and retirement saving plans among the two Canadians in three who earn less than the average wage. The federal Budget's proposal for compulsory membership in private pension plans - after age 25 and one year's service for full-time employees, and

after three years for regular part-time workers who work at least half of the normal work week - apply only to occupational groups where private plans already exist. Workers with below-average earnings are typically found in occupations which do not enjoy private pension membership.

Regulatory reform may even discourage some businesses from sponsoring private pension plans because stricter pension standards will increase their costs, especially smaller employers with low profit margins, a labor-intensive operation and a large proportion of lower-wage workers. The cost of regulatory reform may lead some employers to switch to money-purchase plans, which are generally less desirable from the employee's point of view because they do not guarantee a retirement pension based on a pre-determined formula. Conceivably some employers might even pull out of their pension plans to avoid the proposed stricter standards.

The Budget offers an alternative that is cheaper and simpler for employers - the Registered Pension Account - but we doubt that this new RRSP-like retirement savings vehicle can solve the coverage problem. Our companion report, A Pension Primer, shows that RRSPs are the preserve of affluent professionals and other well-to-do individuals. Few Canadians with average or below-average incomes have an RRSP, and the minority who do cannot afford to contribute enough each year to build up much of a nest egg for their retirement. The income tax system reinforces this pro-affluent bias by allowing deductions for RRSP contributions that reward high-income taxpayers most and low-income persons least.

The Registered Pension Account will suffer from the same weaknesses. And while the RPA is superior to the RRSP in that it will accept employer contributions on behalf of an employee, the employer's participation remains purely voluntary. There is nothing to compel an employer to pay into a Registered Pension Account, nor require or even encourage a lower-wage employee to put what little savings he has into one.

Regulatory change is a very long-term approach to pension reform. The Budget's proposed tougher pension standards will come into effect no later than

January 1, 1987 and will not be retroactive (i.e., they will not affect current pensions and deferred pensions). Today's pensioners will not benefit from the proposed indexation of benefits to 60 percent of the increase in the cost of living each year. Only persons who enter the labor force after the new standards come into force and who will retire in the 2020's and beyond will enjoy the full benefit of the proposed changes.

Regulatory reform will improve retirement incomes overall, but not enough to adequately meet the pension system's income-replacement objective. Research conducted for the Green Paper on pension reform estimated that an even stronger reform package than presented in the Budget still would leave 70 percent of workers with a private pension that replaced less than 25 percent of their pre-retirement earnings.[20] The conclusion is obvious: Regulatory reform must be accompanied by an expansion of the Canada and Quebec Pension Plans to assure Canadians a decent retirement income.

(ii) tax rewards

The current system of tax deductions for retirement savings and pension contributions benefits affluent taxpayers most, middle-income earners less and persons with modest or low incomes little or nothing at all. (Our companion report, A Pension Primer, discusses this issue at length). The Budget proposals will enrich the tax rewards for upper-income taxfilers because they will be allowed to deduct much larger private pension and retirement savings plan contributions from their taxable income, thereby enjoying greater tax savings than under the old system. However Canadians with average incomes or less will gain little if anything from the new tax rules, which in any case will not change the fact that they cannot afford to put much into a retirement savings plan and probably do not belong to a private pension plan in the first place.

The following table gives some examples of how the Budget proposals will affect RRSP contributors at different income levels. We assume they contribute in the maximum allowable amount (18 percent of earnings to a maximum deduction of $10,000 in 1985). The Robin Hood-in-reverse impact of the tax changes is obvious.

Table G

Impact of Budget Proposals on RRSP Contributors, By Earnings, 1985

Earnings	Tax Savings* Before	After	Increase
$30,000	$1,905	$1,905	$ 0
40,000	2,135	2,764	629
50,000	2,442	3,929	1,487
60,000	2,442	4,440	1,998

* Assuming the maximum deductible RRSP contribution

The Budget proposes to raise the tax deduction limit for RRSP contributors without private pension plans from the current $5,500 to $10,000 in 1985. A well-off taxpayer earning $60,000, who puts the maximum tax-deductible amount into an RRSP, will be $2,000 richer as a result of the Budget. A $50,000 earner will enjoy an additional tax saving of $1,487, while an RRSP contributor making $40,000 a year will pay $629 less to Revenue Canada. Tax savings will be even greater after 1985 because the limit on RRSP deductions will be raised to $12,000 in 1985, $14,000 in 1987 and $15,500 in 1988, after which it will be indexed each year to the increase in the average industrial wage. When the new system is fully implemented in 1988, only taxpayers earning $86,000 or more will be able to deduct the maximum allowable amount ($15,500 in 1988) for contributions to private pension and retirement savings plans.

However a $30,000 earner will be no further ahead because his maximum tax savings from the RRSP deduction ($1,905 in the 1985 tax year) will not change. The new formula for establishing a taxfiler's maximum deductible contribution is 18 percent of earnings to a maximum tax deduction of $10,000 for 1985, which would result in a limit of $5,400. Since the $30,000 earner would have been able to deduct $5,500 under the old formula (20 percent of earnings to

a deduction limit of $5,500), he or she will be allowed to use the old approach. (Taxpayers will be able to use either formula until 1988). However very few $30,000 earners can afford a $5,500 contribution to an RRSP, so the $1,905 tax savings figure shown in Table G is optimistically high. Indeed few people with below-average incomes have RRSPs or private pension plans, so the changes in tax incentives proposed in the Budget will not help most Canadians.

(iii) public pensions

Unlike the changes to the private part of the retirement income system, the federal government's plans to strengthen public pension programs will benefit low and middle-income Canadians a good deal. The proposed $50 monthly increase in the Guaranteed Income Supplement will provide a necessary (though not sufficient) increase for single pensioners who are so prone to poverty. The special GIS supplement for the aged who qualify for only partial Old Age Security benefits is an admirable reform that will prevent the emergence of a two-class income security system - one for native-born Canadians, an inferior one for immigrants.

The improvements proposed for the Canada Pension Plan - credit-splitting upon marriage breakdown and when the younger spouse reaches 65, continuation of survivor benefits to those who remarry, raising the year's maximum pensionable earnings to the level of the average industrial wage by 1987 - are welcome and will benefit women in particular. So also would other CPP reforms to be discussed with the provinces, such as lengthening the period of low earnings that can be dropped out when calculating pension benefits, and improvements to survivor benefits.

The Future of Canada's Pension System

Unfortunately the pension reform package presented in the February Budget cannot provide a comprehensive, equitable and lasting solution to the problems afflicting Canada's retirement income system. The proposals will not appreciably open up private pension and retirement savings plans to the majority of Canadians who do not have them now. Improvements to the Canada and Quebec Pension Plans that stop short of expanding benefits beyong the current replace-

ment limit of just one-quarter of the average industrial wage cannot adequately meet the needs of the many who retire with little or no income from private sources. The Guaranteed Income Supplement will continue to serve far more pensioners than ever intended because their retirement income will be so low. Ottawa looks to private initiative to help close the pension income gap, yet chooses to increase public spending on tax breaks that overwhelmingly favor affluent taxpayers who least need a government subsidy to encourage them to save for retirement.

Our contention that half-way pension reform will reinforce and perpetuate the inequities of Canada's retirement income system is supported by the Budget's own estimates of the price tag for its key proposals. In 1984-85, the Guaranteed Income Supplement will cost taxpayers about $2.8 billion; the $50 monthly increase for single GIS recipients will add another $250 million this fiscal year and $460 million in subsequent years. The current tax deductions for contributions to registered pension plans and RRSPs cost the federal and provincial treasuries $5 billion in foregone tax revenues - 1.8 times the cost of the Guaranteed Income Supplement - and the increases in the deduction limits announced in the Budget will raise this enormous expenditure by an estimated $450 million a year - almost the same additional expense as the GIS increase.

The Guaranteed Income Supplement increase will give an extra $600 a year to poor single pensioners and will bring their monthly OAS/GIS payment to $600 by December 1984; though the additional benefit is sorely needed, it would take another $225 a month to bring them to the low-income line for a metropolitan center like Vancouver, Toronto or Montreal. By contrast, **the Budget's enrichment of tax breaks for contributors to private pension and retirement savings plans will reward an affluent $60,000 earner with a tax saving of $4,440 as opposed to $2,442 under the old system - a $2,000 bonus that is over three times the $600 increase in the Guaranteed Income Supplement for poor single pensioners.**

LASTING REFORM

Generations of Canadians have looked to government to improve their retirement income. The federal government has played the key leadership role in building the combination of public and private pension arrangements that we have today.

The beginnings of our retirement income system can be traced as far back as 1870, when the federal government established the first employer-sponsored private pension plan for civil servants; Quebec created a plan for its government employees a few years later. In 1908, Ottawa began to sell annuities to help Canadians save for their retirement. In 1919, it amended the Income Tax Act to allow tax deductions for employee contributions to private pension plans, and measures such as the age exemption, pension income deduction and Registered Retirement Savings Plan came later to encourage saving for retirement and to improve the disposable income of the aged. The federal and most provincial governments enacted benefit standards legislation during the 1960's to regulate employer-sponsored private pension plans, which had multiplied after World War Two.

Ottawa laid the foundation of the modern retirement income system with the Old Age Pension in 1927, an income security program for the aged poor. In 1952, this means-tested benefit was replaced by the universal Old Age Security program for all elderly Candians. The Canada and Quebec Pension Plans were established in 1966 to supplement private pension plans, and the Guaranteed Income Supplement - originally intended as a temporary measure to help those too old to benefit from the Canada/Quebec Pension Plan - was added the same year. The provinces have provided income supplements and tax assistance for their elderly residents.

The three-level retirement income structure that has been developed over the years - government income security programs for the aged, the Canada and Quebec Pension Plans, private pension and retirement savings plans - does not adequately meet the needs of the majority of Canadians, who earn average

wages or below. Theirs is largely a two-level pension system because they get little or nothing from the private part. The fact that half of pensioners still get the Guaranteed Income Supplement says a lot about the failure of our retirement income system.

Ottawa has once again taken the lead in pension reform. Unfortunately, the path that it has chosen - tougher regulations for private pension plans, bigger tax breaks for contributors to private pension and retirement savings plans, improvements to the Canada Pension Plan that stop short of expansion - will mainly strengthen the private level of the pension system, which is not accessible to most Canadians.

The federal government should take pension reform a major step further. Expanding the Canada and Quebec Pension Plans is the only way to ensure an adequate retirement income for Canadians who earn average wages or less during their working years.

In offerring our package of pension reforms, we are well aware that prevailing political opinion is not in favor of expanding the pension system. The recession of the last several years and the uncertainty of economic recovery have firmed the private sector's resolve to lobby against an expansion of either the Canada/Quebec Pension Plan or private pension plans. Their argument that the economy cannot afford a larger pension system is bolstered by the realization that contribution rates will have to rise in future to keep the existing Canada and Quebec Pension Plans solvent. Government financial restraint policies limit increases in income security payments for the elderly. Politicians do not perceive a groundswell of popular support for expanding the Canada/Quebec Pension Plan, and powerful provinces such as Ontario are on record as opposing the idea.

However we believe that Canadians are willing to pay more for better pensions.[21] The problem is that few people understand how poor their retirement income prospects are under the current system, and how inadequate the government's proposed remedies will be for everyone except the affluent.

The reforms proposed in the following pages will strengthen the anti-poverty and income-replacement capacities of the public levels of the retirement income system. However this emphasis in no way precludes a vital role for private pension and retirement savings plans, particularly in meeting the retirement income needs of Canadians who earn above-average incomes during their working years.

Income Security for Canada's Aged

(i) Guaranteed Income Supplement

Maximum benefits from the Old Age Security and Guaranteed Income Supplement total $6,634 for a single elderly person in 1984. The National Council of Welfare estimates the low-income lines at $9,900 for one person living in a metropolitan center (500,000 or more) and $9,403 in a city of 100,000 to 500,000 residents; the majority of elderly Canadians live in communities of this size. Therefore the poverty gap (the number of dollars OAS/GIS maximum payments fall below the poverty line) is substantial - $3,266 for the single aged living in cities the size of Vancouver, Edmonton, Toronto and Montreal and $2,769 for those living in cities of 100,000 to 500,000 such as Regina, Trois-Rivières and Halifax.

Maximum OAS/GIS benefits ($11,436 in 1984) place couples in metropolitan areas $1,628 below the low-income line, $962 under if they live in large cities of 100,000 to 500,000, and $132 below in smaller cities of 30,000 to 100,000. Only aged couples in communities under 30,000 and rural areas are over the poverty line.

The Guaranteed Income Supplement increase announced in the February Budget will bring single pensioners' OAS/GIS income guarantee to $600 a month by December of 1984. To lift them to the low-income line, their GIS benefit would have to be raised from $326 a month to $551 - a substantial 69 percent increase. Elderly couples would require a 27 percent raise in their GIS payment to ensure an income equal to the poverty line for a metropolitan center. Increases of this magnitude are unlikely during the present period of financial restraint.

We propose a two-stage strategy to achieve the retirement income system's anti-poverty objective. The longer-term aim should be to increase the Guaranteed Income Supplement so that, in combination with Old Age Security, it assures all elderly Canadians an income at least equal to the low-income line for metropolitan centers. Our recommendations concerning the C/QPP will reduce the number of GIS recipients in future and therefore make improvements in GIS benefits more financially feasible since they will go to a smaller proportion of aged men and women.

Immediate action is required to help the more than 200,000 single elderly Canadians - most of them women - whose only income is from OAS and GIS. The $50 monthly increase announced in the Budget will close the poverty gap somewhat and improve the income of the single aged vis-à-vis elderly couples. **We recommend an additional $50 monthly increase in the GIS single benefit.**

The following table shows the effects of our proposal. The figures are for December 1984, when the Budget's $50 increase will be fully in effect.

Table H

Impact of GIS Improvements, Single Pensioners, December 1984

	Monthly OAS/GIS	Poverty Gap	As % of Poverty Line	As % of Couple's OAS/GIS
Before Budget	$549	$276	67%	56%
After Budget	600	225	73	62
Additional Increase	650	175	79	67

The Old Age Security and Guaranteed Income Supplement together provide single persons with an income that is only 56 percent of that guaranteed to elderly couples. Yet studies have shown that the cost of living for an

unattached individual is at least two-thirds of that for a couple. Indeed, Statistics Canada's low-income lines for single persons are set at about 75 percent of the level for two-person families.

Our proposal to raise the GIS single benefit by another $50 a month will bring maximum OAS/GIS payments for the single aged to $650 a month. The poverty gap will be further reduced, and elderly single pensioners will receive about two-thirds of a couple's benefit.

We endorse the federal government's plan to provide additional GIS payments for pensioners with partial OAS benefits. Most of these people are immigrants who have not lived in Canada for the 40 years required to qualify for a full OAS pension. This important change will prevent the emergence of a double income standard - one for the majority, a lower one for a minority - that would weaken our income security system for the aged.

(ii) Old Age Security

The Old Age Security benefit should not be allowed to fall below its current proportion of the average industrial wage (14 percent). In 1964, OAS benefits represented 20 percent of the average industrial wage, but that figure fell to just under 14 percent by the mid-'seventies and has stayed at that level since. The decline was due to the fact that average earnings rose faster than the cost of living until 1976; OAS benefits are indexed to prices rather than wages. It is vital that OAS maintain its present relationship to average earnings so that, together with an expanded C/QPP, the program can ensure an adequate retirement income for low and middle-income pensioners.

(iii) Spouse's Allowance

Our report A Pension Primer criticized the Spouse's Allowance because it benefits some low-income spouses and widowed persons between the ages of 60 and 64, but excludes many other near-aged Canadians in equal financial need. Since 1979, the Council has recommended that the **Spouse's Allowance be replaced by an income-tested benefit equivalent to the combined OAS/GIS for all low-income men and women between 60 and 64,** regardless of their marital status.

(iv) Provincial income supplements

While our main concern is federal income security programs for the aged, our report A Pension Primer described a variety of provincial income supplements for the low-income aged. From a national perspective these supplements pose three problems: they are uneven in their amount and extent (Newfoundland, Prince Edward Island, New Brunswick and Quebec have none); they are not protected against inflation; and they tend to favor couples over single persons.

Whatever their amount, provincial supplements are a welcome addition to the income of the aged poor. In an ideal world, all provinces might offer fully indexed supplements, and those which currently pay relatively small amounts would be urged to enrich their benefits. However 1984 is a year of government financial restraint, so it is probably futile to expect provinces such as Newfoundland and New Brunswick to increase their hard-pressed social program budgets by adding a new benefit for the elderly. (Indeed, New Brunswick cancelled its plans to offer a supplement for the aged).

In the future, when Old Age Security and the Guaranteed Income Supplement together guarantee an acceptable income floor for all the aged, the provinces could consider redirecting the money spent on supplements into other forms of assistance for the aged more targetted to their specific needs, such as shelter allowances and public housing. For the present, however, and until such time as the GIS rate for the single aged is brought up to a higher proportion of that for couples, **provinces which offer income supplements should consider adjusting their rates so that a single low-income pensioner gets a larger benefit than each member of an elderly couple.** Ontario has moved in this direction by increasing its provincial supplement for single recipients; federal and provincial income security benefits for the low-income single aged will increase from 52 percent to 60 percent of a couple's payment.

Reforming the Canada and Quebec Pension Plans

(i) improvements to the existing plans

The February 1984 Budget recommended that the **year's maximum pensionable earnings (YMPE) reach the average industrial wage by January 1987.** (Currently the YMPE is $20,800 and estimated average industrial earnings are $22,800). This change alone will significantly improve the C/QPP. The maximum retirement pension this year would be $450 a month instead of the current $387.50 - a sizeable 16 percent increase. Maximum payments from the survivor benefit, disability pension, dependent's benefit and death benefit will improve accordingly.

The Council supports the other reforms that the federal government plans to enact once it receives provincial approval - **credit-splitting upon divorce and when the younger spouse reaches 65,** and **an end to the practice of cutting off survivor benefits on remarriage** (Quebec already has enacted the latter amendment to the Quebec Pension Plan). **Credit-splitting also should occur when one spouse dies.** We recommend that the CPP follow the QPP's practice of allowing contributors to take an **actuarially reduced retirement pension as early as age 60 or an increased pension up to 70.** The plans also would benefit from the Parliamentary Task Force's recommendation to **increase the period of low earnings (from 15 percent to 25 percent of the years from age 18 to 64) that can be excluded when calculating the retirement pension.**

We endorse the Green Paper's proposal for a **survivor benefit (for surviving spouses 65 and older) equal to 60 percent of the deceased spouse's retirement pension (after credit-splitting).**

However we would retain the current limit whereby the survivor benefit and other C/QPP income (such as a retirement pension) cannot exceed the maximum retirement pension; otherwise, surviving spouses from couples with above-average earnings would receive substantially larger benefits than the maximum C/QPP pension available to single persons (who help pay for, but cannot receive, survivor benefits).

The Council does not support the Parliamentary Task Force on Pension Reform's proposal for a 'homemaker pension' from the C/QPP, which we regard as a flawed and inequitable scheme. Our own reforms will meet the retirement income

needs of all Canadians, including homemakers. Better Pensions for Homemakers, a companion report in the Council's series on pension reform, examines the homemaker pension controversy at length.

(ii) expanding the Canada/Quebec Pension Plan

These proposals will strengthen the Canada and Quebec Pension Plans, but not enough to solve the income-replacement problem. The key to pension reform is an expansion of the C/QPP beyond its present limit of one-quarter of earnings up to the average industrial wage. The question is - how far?

Most expansionists have recommended doubling the plan's earnings-replacement capacity to one-half rather than one-quarter of earnings up to the average industrial wage. If such an increase were in effect today (and the YMPE already equalled the average industrial wage), the maximum C/QPP retirement pension would be $900 a month as opposed to $450 under the current (mature) system. There is no question that doubling the earnings-replacement power of the Canada/Quebec Pension Plan would result in a substantial improvement in retirement income and reduced dependence in the Guaranteed Income Supplement.[22]

The catch is the cost of such an expansion. Current actuarial projections indicate that the existing contribution rate (3.6 percent of contributory earnings for the self-employed, 1.8 percent each for employers and employees) will have to increase to between 9 and 11 percent by 2030 just to keep the current C/QPP solvent. (The elderly are forecast to peak at about 6.6 million or 20 percent of the population in the early 2030's, when the baby boom generation gets old). Revised projections, expected later this year, may well set the future CPP contribution rates even higher; the recent Quebec Pension Plan Actuarial Report revised its previous projections upwards and forecast a 12.5 percent contribution rate by 2033.

Doubling the C/QPP's earnings-replacement capacity would require, in rough terms, almost doubling the current contribution rate. If we estimate an 11 percent contribution rate for 2030 under the current plan, then we could expect to pay about 21 percent by 2030 if the C/QPP were expanded to twice its

current replacement rate. In 1984 dollars, a self-employed person with average earnings or above (whose actual contributions this year are $677) would contribute about $2,200 in the year 2030 under the current C/QPP and almost twice this amount if the plan were doubled. An employee earning the average wage or more currently pays $338 in C/QPP contributions; by 2030, he would pay about $1,100 under the existing plan and approximately $2,100 if the C/QPP were doubled.

Expansionists argue that this is not too high a price to pay for better pensions and is in line with what Europeans already pay. The federal and provincial governments, on the other hand, must take into account potential public and employer resistance to future increases in C/QPP contribution rates. Would a self-employed person with average earnings be willing to forego 21 percent of earned income, and an employee 10.5 percent, to finance a doubled C/QPP? Opponents of an expanded C/QPP believe not, and use such figures to condemn the proposal for doubling the plan's earnings-replacement rate as politically unrealistic and economically irresponsible.

We believe that a smaller expansion of the Canada/Quebec Pension Plan would be more saleable to the Canadian people. **The Canada/Quebec Pension Plan should be expanded to replace 37.5 percent of earnings up to the average industrial wage,** as opposed to 25 percent under the current system.

Our proposal will boost the C/QPP's earnings-replacement power by 50 percent (i.e., from 25 percent to 37.5 percent of earnings up to the average industrial wage), whereas the usual proposal to double the plan's earnings-replacement rate would result in a 100 percent increase (i.e., from 25 percent to 50 percent of earnings up to the average). However, as the tables in the next section demonstrate, the Council's '50 percent solution' will markedly improve retirement income and reduce reliance on the Guaranteed Income Supplement.

The cost of our expansion would not be onerous. The combined employer/employee contribution rate, currently 3.6 percent, will have to increase to about 6 percent in 2000 and 11 percent by 2030 to finance the existing plan. Our proposed expansion would require a combined contribution

rate of around 9 percent by 2000 and perhaps 16 percent by the 'worst' year, 2030. An employee's contribution, of course, would be half these amounts. Under the Council's improved Canada/Quebec Pension Plan, an employee would contribute about 4.5 percent of contributory earnings in 2000 and 8 percent by the 2030's.

When the Canada and Quebec Pension Plans were introduced, full benefits were phased in over the ten-year period between 1966 and 1976. The expanded C/QPP also should be phased in over a ten-year period. This approach would help win public support for the expanded plan and acceptance of the higher contributions required to finance improvements, since current contributors would receive larger benefits when they retire. To minimize the disparity between those already retired (and therefore receiving benefits under the old plan) and those who retire under the new plan, consideration should be given to improving benefits for current pensioners as well.

Our report Financing the Canada Pension Plan recommended that the **Canada Pension Plan be shifted to pay-as-you-go financing.** Contributions would be set at a rate that would cover current pension payments and maintain a contingency reserve to adjust to short-term fluctuations in revenues and expenditures. The provinces should be required to pay full net interest on their previous borrowings from the CPP fund.

Tax Reforms

The tax deduction for contributions to the C/QPP should be converted to a tax credit. The tax deduction benefits affluent contributors most and poor contributors least. A tax credit would reverse this inequitable situation and help low-wage contributors most. A C/QPP contributor's credit also would reduce the burden of the increased contribution rate for men and women who earn below the average wage.

The higher tax deduction limits for contributions to private pension and savings plans proposed in the February 1984 Budget will mainly benefit affluent taxfilers. **The tax deduction for private pension and savings plan contributions should be replaced by a tax credit** designed to provide

proportionately larger benefits to smaller contributors. **The age exemption,** which is also a regressive measure, **should be changed to a credit**; as the retirement income system matures and provides adequate retirement income, Ottawa could consider eliminating this feature entirely.

The Benefits of Reform

Pension reform is a complex jigsaw puzzle made up of many parts. Will our proposals fit together to form a coherent and acceptable picture?

Table I looks at single pensioners who earned on average one-half, three-quarters and the full average industrial wage during their working years. The 'poverty gap' is the difference between retirement income and the low-income line (an estimated $9,900 for one person in a metropolitan area). The 'replacement ratio' shows retirement income as a percentage of net pre-retirement earnings (i.e., earnings less C/QPP contributions, unemployment insurance premiums and federal and provincial income taxes).

Table I

Public Pension Income, Single Pensioners, Old and New System, 1984

	Pre-retirement Earnings					
Retirement Income	1/2 average ($11,400)		3/4 average ($17,100)		Average ($22,800)	
	Old	New	Old	New	Old	New
OAS	$3,220	$3,220	$3,220	$3,220	$3,220	$3,220
GIS	2,488	2,413	1,813	1,401	1,138	388
C/QPP	2,700	4,050	4,050	6,075	5,400	8,100
Total	$8,408	$9,683	$9,083	$10,696	$9,758	$11,708
Poverty Gap	- 1,492	- 217	- 817	796	- 142	1,808
Replacement Ratio	86%	100%	66%	78%	55%	67%

Once the existing system is mature (i.e., when the YMPE reaches average earnings by 1987), the maximum C/QPP retirement pension will be $450 in 1984 dollars. However public retirement benefits will leave all single pensioners shown on Table I below the low-income line. Even the pensioner with average earnings before retirement will qualify for some GIS benefits and will end up with a retirement income that is only 55 percent of pre-retirement earnings.

Our proposal (illustrated in the "New" columns) would raise C/QPP retirement benefits by 50 percent and the Guaranteed Income Supplement for single pensioners by $50 a month (over and above the $50 increase announced in the February 1984 Budget). Pensioners who earned an average lifetime income of half the average industrial wage would have their retirement income raised to within a few hundred dollars of the low-income line; an additional GIS increase, as we have recommended, could close the gap. Single pensioners who earned three-quarters and the full average wage would rely less on the Guaranteed Income Supplement - a change that would save taxpayers money - and would see a substantially better replacement ratio. Pensioners with average earnings would get 69 percent of their public retirement income from the C/QPP, as opposed to only 55 percent under the old system.

Table J shows existing and proposed retirement income for couples with one earner. As with single pensioners, couples would receive a better C/QPP retirement pension and would rely less on the Guaranteed Income Supplement. The couple with half the average pre-retirement earnings would receive a retirement income that is above the poverty line (an estimated $13,063 for a couple living in a city of 500,000 or more). Couples with average earnings before retirement would receive 52 percent of their retirement income from the Canada/Quebec Pension Plan, whereas under the current system the C/QPP will make up only 38 percent of their income.

Table J

Public Pension Income, One-Earner Couples, Old and New System, 1984

Retirement Income	1/2 average ($11,400) Old	1/2 average ($11,400) New	3/4 average ($17,100) Old	3/4 average ($17,100) New	Average ($22,800) Old	Average ($22,800) New
OAS	$6,440	$6,440	$6,440	$6,440	$6,440	$6,440
GIS	3,644	2,969	2,969	1,957	2,294	944
C/QPP	2,700	4,050	4,050	6,075	5,400	8,100
Total	$12,784	$13,459	$13,459	$14,472	$14,134	$15,484
Poverty Gap	- 279	396	396	1,409	1,071	2,421
Replacement Ratio	118%	125%	91%	98%	75%	82%

(Column headings: Pre-retirement Earnings)

Table K compares what two-earner couples would get under the current and proposed pension systems. The Council's recommended expansion of the Canada/Quebec Pension Plan would bring all couples in Table K above the low-income line, improve their retirement income and lessen their demands on the Guaranteed Income Supplement.

Table L examines current and proposed retirement benefits for surviving spouses from one-earner couples. We assume the survivor worked in the home, so she would fit the common label of 'widowed homemaker'.

Table K

Public Pension Income, Two-Earner Couples, Old and New System, 1984

Retirement Income	1/2 average[1] ($11,400) Old	New	3/4 average[2] ($17,100) Old	New	Average[3] ($22,800) Old	New
OAS	$6,440	$6,440	$6,440	$6,440	$6,440	$6,440
GIS	3,644	2,294	2,969	1,957	2,294	944
C/QPP	2,700	4,050	4,050	6,075	5,400	8,100
Total	$12,784	$13,459	$13,459	$14,472	$14,134	$15,484
Poverty Gap	- 279	396	396	1,409	1,071	2,421
Replacement Ratio	116%	122%	88%	95%	73%	80%

Pre-retirement Earnings

1. each spouse earned ¼ average industrial wage
2. one spouse earned ¼, one spouse ½, average
3. each spouse earned ½ average

Table L

Public Pension Income, Surviving Spouses, One-Earner Couples, Old and New System, 1984

Couple's Pre-retirement Earnings

Survivor's Retirement Income	1/2 average ($11,400) Old	New	3/4 average ($17,100) Old	New	Average ($22,800) Old	New
OAS	$3,220	$3,220	$3,220	$3,220	$3,220	$3,220
GIS	3,028	2,818	2,623	2,008	2,218	1,198
C/QPP	1,620	3,240	2,430	4,860	3,240	6,480
Total	$7,868	$9,279	$8,273	$10,088	$8,678	$10,898
Poverty Gap	-2,032	- 622	-1,627	188	-1,222	998
Replacement Ratio*	62%	69%	61%	70%	61%	70%

* Survivor's retirement income as a percentage of couple's retirement income

Unless the pension system is reformed, most elderly widows will continue to live on very low incomes. Surviving spouses at all levels of pre-retirement earnings shown on Table L, including those at the average wage, will end up thousands of dollars below the poverty line. Our proposals - an expanded C/QPP, credit-splitting upon retirement, a 60 percent survivor benefit, and a $50 increase in the GIS single benefit - will markedly improve widows' income, bringing it to 70 percent of the couple's retirement income. As we mentioned earlier, an additional future increase in the Guaranteed Income Supplement could close the poverty gap for widows from low-wage families.

Table M looks at widows from two-earner couples. The benefits of our reforms are obvious.

Table M

Public Pension Income, Surviving Spouses, Two-Earner Couples, Old and New System, 1984

	Couple's Pre-retirement Earnings					
Survivor's Retirement Income	1/2 average[1] ($11,400)		3/4 average[2] ($17,100)		Average[3] ($22,800)	
	Old	New	Old	New	Old	New
OAS	$3,220	$3,220	$3,220	$3,220	$3,220	$3,220
GIS	2,758	2,278	2,353	2,008	1,678	1,198
C/QPP	2,160	3,240	2,970	4,860	4,320	6,480
Total	$8,138	$9,279	$8,543	$10,088	$9,218	$10,898
Poverty Gap	-1,762	- 622	-1,357	188	- 682	998
Replacement Ratio[4]	64%	69%	63%	70%	65%	70%

1. each spouse earned ¼ average industrial wage
2. one spouse earned ¼, one spouse ½, average
3. each spouse earned ½ average
4. survivor's retirement income as a percentage of couple's retirement income

There is no question that expanding the Canada and Quebec Pension Plans is the key to successful pension reform.

FOOTNOTES

1. These rates are for the second quarter (i.e., April, May and June) of 1984.

2. Operating expenditures for OAS, GIS and the Spouse's Allowance are estimated at $37,955,000 for 1983-84, or less than one-half of one percent of total expenditures of $10,943,955,000. See Government of Canada, 1983-84 Estimates Part III Health and Welfare Canada (Ottawa: Minister of Supply and Services Canada, 1983), p.3-27.

3. National Council of Welfare. Sixty-Five and Older (Ottawa: Minister of Supply and Services Canada, 1984), pp. 42-44.

4. Newfoundland, Prince Edward Island, New Brunswick and Quebec do not provide income supplements for the aged, though they do offer tax concessions. See the National Council of Welfare, A Pension Primer (Ottawa: Minister of Supply and Services Canada, 1984), pp. 12-14 and Appendices A and B.

5. Statistics Canada defines an "unattached individual" as a person "living alone or in a household where he/she is not related to other household members". Thus an unattached elderly person may live alone, or with a friend. Statistics Canada, Income Distributions by Size in Canada, 1981 (Ottawa: Minister of Supply and Services Canada, 1983) p.22.

6. We assume the following division of earnings between spouses: at three-quarters of average earnings, one spouse earned one-quarter and the other spouse one-half the average industrial wage; each spouse in the couple with average earnings made one-half of average earnings; and one spouse earned the average and the other spouse half the average in the couple with 1.5 times average earnings.

7. Economic Council of Canada. One in Three (Ottawa: Minister of Supply and Services Canada, 1979), p. 38.

8. Business Committee on Pension Policy. Pension Policy - Issues and Positions (August 10, 1982).

9. Government of Canada. Better Pension for Canadians (Ottawa: Minister of Supply and Services Canada, 1982), p. 29.

10. Parliamentary Task Force on Pension Reform. Report (Ottawa: House of Commons, 1983), pp.49-50.

11. The Honourable Marc Lalonde. Action Plan for Pension Reform: Building Better Pensions for Canadians (Ottawa: Department of Finance Canada, February 1984), p. 10.

12. Canadian Life and Health Insurance Association, Inc. A National Pension System (Toronto: 1981).

13. Report of the Royal Commission on the Status of Pensions in Ontario. Volume II. Design for Retirement (Toronto: Government of Ontario, 1980), pp.308-319.

14. Ascah, Louis, Robert Baldwin and James Pesando. Commentaries on the Haley Report on Pensions (Toronto: Ontario Economic Council, 1981).

15. Michael Mendelson.

16. Economic Council of Canada. One in Three (Ottawa: Minister of Supply and Services Canada, 1979), p.52.

17. Canadian Labour Congress. The CLC Proposal for Pension Reform (Ottawa: 1982), Section V.

18. Action Plan for Pension Reform, pp. 8-9.

19. Gibb-Clark, Margot. "Pension Reform Plan on Way, Quebec Told". Globe and Mail (Toronto: February 1, 1984).

20. Government of Canada. "Lifetime Coverage", Background Note No.4, Better Pensions for Canadians (Ottawa: Task Force on Pensions, Privy Council Office), p. 25.

21. An Ontario survey conducted by the Royal Commission on the Status of Pensions in Ontario found that the majority of respondents (57 percent) were willing to pay higher CPP contributions in return for better retirement benefits. Fourteen percent were undecided and only 29 percent opposed the idea. Report of the Royal Commission on the Status of Pensions in Ontario. Volume VIII. Background Studies and Papers (Toronto: Government of Ontario, 1980), p. 40.

22. A series of tables comparing public retirement income under the current system and an expanded (doubled) C/QPP is available from the National Council of Welfare. The tables are the same as Tables I to M, except that the latter illustrate the smaller expansion recommended in this report.

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The National Council of Welfare was established by the Government Organization Act, 1969 as a citizens' advisory body to the Minister of National Health and Welfare. Its mandate is to advise the Minister on matters pertaining to welfare.

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